

CHAPTER 39
FILING RETURN AND PAYMENT OF TAX

[Prior to 12/17/86, Revenue Department[730]]

701—39.1(422) Who must file.

39.1(1) Residents.

a. For tax years beginning prior to January 1, 1993. For each taxable year, every resident of Iowa, except any resident claimed as a dependent on another person's return, whose net income, as defined in Iowa Code section 422.7, is \$4,000 or more (\$5,000 or more for taxable years beginning on or after January 1, 1987, but before January 1, 1992), (\$7,500 or more for taxable years beginning in the 1992 year), or who is required to file a federal income tax return if it is for a tax year beginning before January 1, 1992, must make, sign, and file a return. Each resident whose net income as defined in Iowa Code section 422.7 is \$3,000 or more and who is claimed as a dependent on another person's return, or who is required to file a federal income tax return if it is for a tax year beginning before January 1, 1992, must make, sign, and file a return. In determining whether returns must be filed, income from all sources, taxable under this division, must be considered. For purposes of this paragraph, the portion of a lump sum distribution subject to separate federal tax is included in net income to determine if a person has to file a return.

b. For tax years beginning on or after January 1, 1993. For each taxable year every resident of Iowa, except any resident claimed as a dependent on another person's return, whose net income is greater than \$13,500 in the case of married persons filing jointly, filing separately on a combined return or filing separate returns, unmarried heads of household and surviving spouses or greater than \$9,000 in the case of single persons must make, sign, and file a return. Each resident who is claimed as a dependent on another person's return and whose net income is \$4,000 or more must make, sign, and file a return. For purposes of this paragraph, the portion of a lump sum distribution subject to separate federal tax is included in net income to determine if a person has to file a return.

39.1(2) Nonresidents.

a. Tax years beginning on or before December 31, 1981. For each taxable year, every nonresident of Iowa who is not claimed as a dependent on another person's return, but is required to file a federal income tax return and who has a net income, as defined in Iowa Code section 422.7, from sources within this state of \$4,000 or more, must make, sign and file a nonresident return. Each nonresident who is claimed as a dependent on another person's return, and whose net income, as defined in Iowa Code section 422.7, from sources within this state is \$3,000 or more, and who is required to file a federal income tax return, must make, sign and file a nonresident return.

b. Tax years beginning on or after January 1, 1982, but before January 1, 1993. For each taxable year, every nonresident of Iowa must make, sign, and file an Iowa return if the nonresident has a net income of \$500 or more from Iowa sources and meets one or more of the following conditions: (1) is required to file a federal income tax return if the taxable year begins before January 1, 1992, (2) has a net income from all sources of \$4,000 (\$5,000 for tax years beginning on or after January 1, 1987, but before January 1, 1992), (\$7,500 or more for taxable years beginning in the 1992 year), or (3) is claimed as a dependent on another person's return and had a net income from all sources of \$3,000 or more.

c. *Tax years beginning on or after January 1, 1993.* For each taxable year, every nonresident of Iowa must make, sign, and file an Iowa return if the nonresident has a net income of \$1,000 or more from Iowa sources and meets one or more of the following conditions: (1) has a net income from all sources that is greater than \$13,500 in the case of married persons filing jointly, filing separately on a combined return or filing separate returns, unmarried heads of household and surviving spouses, (2) has a net income from all sources greater than \$9,000 in the case of single persons, (3) is claimed as a dependent on another person's return and has a net income from all sources of \$4,000 or more. For purposes of this paragraph, the portion of a lump sum distribution subject to separate federal tax that is allocable to Iowa is included in net income to determine if the nonresident has sufficient net income to make and file a return.

39.1(3) Part-year residents.

a. *Tax years beginning on or before December 31, 1981.* Every part-year resident of Iowa, except those part-year residents claimed as a dependent on another person's return, whose net income earned from all sources during the time the person was a resident and whose net income earned from Iowa sources for the portion of the year the person was a nonresident, totals \$4,000 or more, or every part-year resident who is required to file a federal income tax return, must make, sign and file an Iowa resident income tax return. Every part-year resident of Iowa, who is claimed as a dependent on another person's return, and whose net income earned from all sources during the time the person was a resident and whose net income earned from Iowa sources for the portion of the year the person was a nonresident, totals \$3,000 or over, or every part-year resident who is required to file a federal income tax return, must make, sign and file an Iowa income tax return.

b. *Tax years beginning on or after January 1, 1982, but before January 1, 1993.* For each taxable year, every part-year resident of Iowa must make, sign, and file an Iowa return if the part-year resident has a net income of \$500 or more from Iowa sources and meets one or more of the following conditions: (1) is required to file a federal income tax return if the taxable year begins before January 1, 1992, (2) has a net income from all sources of \$4,000 or more (\$5,000 or more for tax years beginning on or after January 1, 1987, but before January 1, 1992), (\$7,500 or more for tax years beginning in the 1992 year), or (3) is claimed as a dependent on another person's return and had a net income from all sources of \$3,000 or more.

See rules 701—40.16(422), 41.7(422) and 701—subrule 42.2(1).

c. *Tax years beginning on or after January 1, 1993.* For each taxable year, every part-year resident of Iowa must make, sign, and file a return if the individual has a net income of \$1,000 or more from Iowa sources and meets one or more of the following conditions: (1) has a net income from all sources that is greater than \$13,500 in the case of married persons filing jointly, filing separately on a combined return form or filing separate returns, unmarried heads of household and surviving spouses, (2) has a net income from all sources that is greater than \$9,000 in the case of a single person, or (3) is claimed as a dependent on another person's return and had a net income from all sources of \$4,000 or more. For purposes of this paragraph, the portion of a lump sum distribution that is allocable to Iowa is included in net income to determine if the person has sufficient net income to make and file a return.

39.1(4) Returns of the handicapped. If a taxpayer is physically or mentally unable to make a return, the return shall be made by a duly authorized agent, guardian or other person charged with the care of the person or property of such taxpayer. A power of attorney must accompany a return made by an agent or guardian.

39.1(5) Minimum income requirement. See rules 701—40.1(422) to 40.52(422) and any subsequent rules in Chapter 40 for the computation of net income to determine if a taxpayer meets the minimum filing requirements described in subrules 39.1(1), 39.1(2), and 39.1(3).

39.1(6) Final return. If a taxpayer has died during the year, see paragraph 39.4(2)“d.”

39.1(7) Returns filed for refund. A taxpayer whose Iowa source net income or all source net income is less than the amount for which the filing of an Iowa individual income tax return is required must file a return to receive a refund of Iowa income tax withheld or Iowa estimate tax paid in the tax year or to receive a refund from an Iowa refundable tax credit. Refundable tax credits include the child and dependent care credit, the research activities credit and the motor vehicle fuel tax credit.

This rule is intended to implement Iowa Code sections 422.5 and 422.13 as amended by 1993 Iowa Acts, chapter 123.

701—39.2(422) Time and place for filing.

39.2(1) Returns of individuals. A return of income must be filed on or before the due date. The due date is the last day of the fourth month following the close of the taxpayer's taxable year, whether the return be made on the basis of the calendar year or for a fiscal year, or the last day of the period covered by an extension of time granted by the department. When the due date falls on Saturday, Sunday or a legal holiday, the return will be due the first business day following the Saturday, Sunday or legal holiday. If a return is placed in the mails, properly addressed and postage paid, in ample time to reach the department on or before the due date for filing, no penalty will attach should the return not be received until after that date. Mailed returns should be addressed to Income Tax Return Processing, Department of Revenue and Finance, Hoover State Office Building, Des Moines, Iowa 50319.

Farmers and fishermen have the same filing due date as other individual taxpayers, however, those farmers and fishermen who have elected not to file a declaration of estimated tax shall file their returns and pay the tax due, on or before March 1, to avoid penalty for underpayment of estimated tax.

39.2(2) Extension of time for filing returns for tax years beginning prior to January 1, 1986. The taxpayer must file on or before the due date a return which is as nearly complete and final as it is possible to prepare. However, when good cause exists because of sickness, unavoidable absence, or other legitimate reasons, the director is authorized to grant an extension of time in which to file the return, provided the taxpayer files the appropriate form as prescribed by the director and in the time period as required by the director.

Form IA 4868 (Application for Automatic Extension of Time to File Iowa Individual or Partnership Tax Return) shall be used to request an initial four-month extension of time for filing. Only one copy of Form IA 4868 need be filed on or before the due date of the return. If the taxpayer wishes acknowledgment of receipt by the department of Form IA 4868, two copies and a self-addressed envelope shall be filed with the department.

Form IA 2688 (Application for Additional Extension of Time to File Individual or Partnership Income Tax Return) shall be used to request an additional extension of time to file. Form IA 2688 must be submitted in sufficient time to enable the department to consider and to act on the application before the expiration of the previous extension of time to file.

A copy of the timely filed automatic extension request and any other Iowa approved extensions must be attached to the return at time of filing. A copy of an approved federal extension attached to the Iowa return will not be acceptable in lieu of an Iowa extension.

Extensions of time will not normally be granted for more than six months (four months for the automatic and two months for the second extension), except in instances where a completed federal return has not yet been filed and the additional time is necessary to file a complete Iowa return. The application for an extension must be made prior to the due date of the return, or before the expiration of an extension previously granted. As a condition to granting an extension of time, the director will require that a tentative return be filed and that the full amount of estimated tax shown due on the return be paid.

If the time for filing is extended, interest as provided by law, from the date the return originally was required to be filed to the date of actual payment of the tax, is to be computed on the unpaid tax. See rule 701—10.2(421) for the statutory interest rate commencing on or after January 1, 1982.

39.2(3) *Extension of time for filing returns for tax years beginning on or after January 1, 1986, but before January 1, 1991.* The taxpayer is required to file the taxpayer's individual income tax return with the department on or before the due date of the return with payment in full of the amount required to be shown with the return. However, in any instance where the taxpayer is unable to file the return by the due date, because of death or serious illness in the taxpayer's family, unavoidable absence from Iowa, destruction of the taxpayer's records by fire or other casualty or other legitimate reason, the taxpayer or the taxpayer's authorized representative may file an application with the department for an extension of the due date to file the taxpayer's return. The taxpayer's application for extension will be considered valid by the department and no penalty will be assessed on an amount due when the return is filed during the period covered by the extension, if the requirements set out below in paragraphs "a" and "b" are met.

a. Filing the automatic extension application on or before the due date of the return. The taxpayer must file the automatic extension application form with the department on or before the due date of the return. The extension application is to be filed on Form IA 4868 (Application for Automatic Extension of Time to File Iowa Individual or Partnership Tax Return). Only one copy of Form IA 4868 needs to be filed with the department. The taxpayer is to complete a second copy of the automatic application form which is to be attached to the return form, when that form is filed with the department. However, in any case when the taxpayer wants the department to acknowledge receipt of the extension form, the taxpayer is to send two completed application forms and a stamped self-addressed envelope to the department. The department will return one of the application forms to the taxpayer which will include a notation to show that the application was received by the department. The automatic extension form covers a four-month period. In the case of a taxpayer on a calendar-year basis, the period covered by the extension is from May 1 through August 31.

b. Payment of at least 90 percent of the tax by the due date. The taxpayer must have paid at least 90 percent of the tax required to have been shown due on the return on or before the due date of the return. To determine whether or not at least 90 percent of the tax was "paid" on or before the due date the aggregate of the amounts of tax credits applicable on the return plus the tax payments which were made on or before the due date of the return is divided by the individual's income tax liability. The individual's tax liability is the sum of the taxpayer's income tax, lump-sum tax, and the minimum tax. In the case of the 1985 return, the individual's tax liability is the total on line 54 of the Form IA 1040. The tax credits applicable are the total amounts of the personal exemption credits, child care credit, political contribution credit, nonresident credit, part-year resident credit, out-of-state credit, motor vehicle fuel tax credit, research activities credit and jobs tax credit. This is the total of the amounts on lines 55, 56, 57, 60, 71, 72, and 73 of the Form IA 1040 for 1985. The tax payments to be considered for purposes of determining if 90 percent of the tax was paid are the Iowa income tax withheld, the estimate payments, payments made with the extension and any other payments of the taxpayer for the tax year which were made by the taxpayer by the due date of the return for which the extension was requested.

If the aggregate of the tax credits and the tax payments is equal to or greater than 90 percent of the tax liability required to be shown due, the taxpayer will have met the “90 percent” test and the taxpayer’s extension will be deemed valid. Therefore, no penalty will be assessed on any amount due when the return is filed within the extension period. However, interest will accrue on the amount required to be shown when the return is filed from the due date of the return through the month in which the return is filed and the tax is paid at the interest rate which is applicable for the year in which the return was to be filed. Interest will continue to accrue if the tax is not paid when the return is filed.

c. *Requesting an additional extension in which to file the return.* If the taxpayer is unable to file the return by the end of the period of the automatic extension because of unavoidable absence or other legitimate reason, the taxpayer or the taxpayer’s representative may request an additional extension to file on Form IA 2688. Form IA 2688 (Application for Additional Extension of Time to File Individual or Partnership Income Tax Return) is to be filed in duplicate with the department on or before the last day of the period covered by the automatic extension. The taxpayer or the taxpayer’s representative shall state on the extension form the reason or reasons for requesting additional time to file the taxpayer’s return.

The application for additional extension of time to file will be rejected by the department, if the application form was not requested timely or if the application form was not signed by either the taxpayer or the taxpayer’s representative. The application will also be rejected if the reason given for the extension request is that the taxpayer is unable to pay or that the taxpayer had requested a federal extension.

The department will return one of the taxpayer’s applications for additional extension forms to the taxpayer or the taxpayer’s representative. The department will indicate on the application form whether the extension application is approved or rejected and the reason for rejection.

The fact that a taxpayer’s application for additional extension was approved by the department does not mean that the taxpayer is not subject to penalty in a situation where the taxpayer has paid less than 90 percent of the tax required to have been shown on the return by the due date of the return.

The application for additional extension of time covers a two-month period beginning with the end of the “automatic” extension. Extension applications will not be granted for more than six months except in unusual situations where circumstances beyond the taxpayer’s control have prevented the taxpayer from filing the return within the extended period.

39.2(4) *Extension of time for returns for tax years beginning on or after January 1, 1991.* The taxpayer is required to file the taxpayer’s individual income tax return on or before the due date of the return with payment in full of the amount required to be shown due with the return. However, in any instance where the taxpayer is unable to file the return by the due date because of illness or death in the taxpayer’s immediate family, unavoidable absence of the taxpayer, or other legitimate reason, the director may grant a six-month extension of time to file the return.

If the taxpayer has paid at least 90 percent of the tax required to be shown due by the due date and has not filed a return by the due date, the director will consider that the taxpayer has requested an extension of time to file the return and will automatically grant an extension of up to six months to file the return. The taxpayer does not have to file an application for extension form with the department to get the automatic extension to file the return within the six-month period after the due date and not be subject to penalty. However, if the taxpayer wants to make a tax payment to ensure that at least 90 percent of the tax has been paid on or before the due date, the payment should be made with the Iowa tax voucher form. This form can be requested from the Taxpayer Services Section, P.O. Box 10457, Des Moines, Iowa 50306, or by telephone at (515)281-3114.

To determine whether or not at least 90 percent of the tax was “paid” on or before the due date, the aggregate amount of tax credits applicable on the return plus the tax payments made on or before the due date are divided by the tax required to be shown due on the return. The tax required to be shown on the return is the sum of the income tax, lump-sum tax, minimum tax, and school district income surtax. The tax credits applicable are the credits set out in Iowa Code sections 422.8, 422.10, 422.11A, 422.11B, 422.11C, 422.12, 422.12B, 422.12C and 422.111. The tax payments to be considered for purposes of determining if 90 percent of the tax was paid are the withholding tax payments, estimate payments, and the payments made with the Iowa income tax voucher form to ensure that 90 percent of the tax was paid timely.

If the aggregate of the tax credits and the tax payments are equal to or greater than 90 percent of the tax required to be shown due, the taxpayer will have met the “90 percent” test and no penalty will be assessed. However, the taxpayer will still be subject to statutory interest on any tax due when the return is filed.

Any tax elections, such as the election to carry forward a net operating loss occurring in the tax year, will be considered to be valid in instances when the return is filed within the six-month extended period after the due date. The fact that the taxpayer has paid less than 90 percent of the tax required to be shown due will not invalidate any tax elections made on the return, if the return is filed within the six-month extended period.

a. Extensions for taxpayers with tax homes outside the United States and Puerto Rico. Taxpayers with tax homes outside the United States and Puerto Rico may, in some situations, be granted additional time to file their federal income tax returns beyond the six-month period after the federal due date. In some cases, this additional time is needed to meet residency time requirements in a foreign country so the taxpayer will be eligible for the foreign income exclusion which is also applicable to filing Iowa income tax returns. In cases where the taxpayer’s tax home is outside the United States and the taxpayer has been granted additional time to file the federal income tax return which is greater than six months from the due date, the taxpayer will be deemed to have the same additional time to file the Iowa return and not be subject to penalty for late filing if 90 percent of the tax required to be shown due on the return was paid by the due date. Taxpayers with tax elections filing returns under these circumstances will be considered to have made these elections timely. However, the taxpayers should attach to their Iowa return documentation showing they were granted additional time after the six-month period from the due date to file their federal returns.

b. Payment of interest on refunds from income tax returns filed in the six-month period after the due date. The following information applies only to Iowa individual income tax returns that are filed for tax years beginning on or after January 1, 1999. In the case of Iowa returns that have overpayments of income tax that are filed in the six-month period after the due date and where at least 90 percent of the tax shown due was paid by the due date, interest at the statutory rate will be paid on the overpayments determined on the returns, starting on the first day of the second month after the end of the six-month extended period and ending in the month in which the refund is issued.

For taxpayers filing Iowa individual income tax returns for calendar-year tax years, the six-month extended period starts May 1 of the year following the end of the tax year and ends on October 31 of the year following the end of the tax year. However, if April 30 falls on a Sunday as it does in the year 2000 for 1999 Iowa individual returns filed in that year, the due date is moved to Monday, May 1. The extended period in this instance starts on Tuesday, May 2, 2000, and ends on October 31, 2000.

EXAMPLE. A husband and wife file their 1999 Iowa return on September 15, 2000. This return has an overpayment of tax of \$200. Because the return is filed in the six-month period after the May 1, 2000, due date, and because the refund is issued in January 2001, interest accrues on the overpayment for the months of December 2000 and January 2001.

This rule is intended to implement Iowa Code section 422.21 and Iowa Code Supplement section 422.25.

701—39.3(422) Form for filing.

39.3(1) *Use of and completeness of prescribed forms.* Returns shall, in all cases, be made by residents and nonresidents on forms supplied by the department of revenue and finance. Taxpayers not supplied with the proper forms shall make application for the forms to the department, in ample time to have their returns made, verified and filed on or before the due date. Each taxpayer shall carefully prepare a return so as to fully and clearly set forth the data required. For lack of a prescribed form, a statement made by a taxpayer disclosing gross income and the deductions from gross income may be accepted as a tentative return, and if verified and filed within the prescribed time, will relieve the taxpayer from liability to penalties, provided that without unnecessary delay a tentative return is replaced by a return made on the proper form. Each question shall be answered and each direction complied with in the same manner as if the forms and instructions were embodied in these regulations. Individual resident taxpayers shall enter the name of the school district of residence on the return. If the school district is not supplied, the return shall be deemed incomplete.

A return not signed by the taxpayer or the taxpayer's agent or guardian, shall not be deemed completely executed and filed as required by law.

Failure to receive the proper form does not relieve the taxpayer from the obligation of making any return required by statute.

39.3(2) *Optional method of filing.* The front and back page of the Iowa individual income tax return, if properly completed, may be filed as an optional return, if a complete facsimile or photocopy of the federal return and supporting schedules are attached.

39.3(3) *Copy of federal income tax return to be filed by nonresident.* A nonresident taxpayer must file a copy of their federal income tax return for the current tax year with their Iowa income tax return. The copy shall include full and complete copies of all farm, business, capital gains and other schedules that were filed with the federal return.

39.3(4) *Amended returns.* If it becomes known to the taxpayer that the amount of income reported to be federal net income or Iowa taxable income was erroneously stated on the Iowa return, or changed by an Internal Revenue Service audit, or otherwise, the taxpayer shall file an amended Iowa return along with supporting schedules, to include the amended federal return if applicable. A copy of the federal revenue agent's report and notification of final federal adjustments provided by the taxpayer will be acceptable in lieu of an amended return. The assessment or refund of tax shall be dependent on the statute of limitations as set forth in 701—subrule 38.2(1) and rule 701—43.3(422).

39.3(5) *Voter's registration forms in income tax booklets and income tax return instructions.* Effective for tax years beginning on or after January 1, 1989, income tax return booklets and income tax return instructions shall include two voter registration forms. The voter registration forms to be inserted into the income tax return instruction forms and booklets are to be designed by the voter registration commission. However, effective July 1, 1992, the voter registration forms are to be inserted in the income tax return booklets and income tax return instructions only for odd-numbered tax years. Thus, the voter registration forms will not be included in the income tax return booklets for the 1992 tax year but are to be included in the booklets for 1993.

This rule is intended to implement Iowa Code sections 48.21, 422.21 and 422.22, Iowa Code section 422.13 and 1994 Iowa Acts, Senate File 2223.

701—39.4(422) Filing status.

39.4(1) *Single taxpayers.* The term "single person" includes, for income tax purposes, an unmarried person, a person legally separated under a decree of divorce or separate maintenance or any other person not properly classified under subrules 39.4(2) through 39.4(8).

39.4(2) *Married taxpayers.* A taxpayer is considered married for the entire year if on the last day of the tax year the taxpayer is (a) married and living together with the taxpayer's spouse, (b) married and living apart from the spouse, but not legally separated under a decree of divorce or separate maintenance, (c) living together with the spouse in a common law marriage that is recognized by the state where the common law marriage exists or (d) widowed but the spouse died during the year.

39.4(3) Common law marriage. A common law marriage is a social relationship between a man and a woman that meets all the necessary requisites of a marriage except that it was not solemnized, performed or witnessed by an official authorized by law to perform marriages. The necessary elements of a common law marriage are: (a) a present intent of both parties freely given to become married, (b) a public declaration by the parties or a holding out to the public that they are husband and wife, (c) continuous cohabitation together as husband and wife (this means consummation of the marriage), and (d) both parties must be capable of entering into the marriage relationship. No special time limit is necessary to establish a common law marriage. Iowa recognizes, for income tax purposes, all valid common law marriages.

39.4(4) Married filing jointly. Married taxpayers who file a joint return with the Internal Revenue Service may file a joint return with the Iowa department of revenue and finance.

39.4(5) Married filing separately on the same form. Married taxpayers may file separately on the same form. This return is also known as the combined return. If a married taxpayer files a combined return with his or her spouse, any refund will be issued in both names.

39.4(6) Married filing separately. Married taxpayers, each having income in his or her own right, may file separate returns if they do not wish to file separately on the same form.

39.4(7) Head of household. The term “head of household” denotes a single individual and shall have the same meaning as defined in the Internal Revenue Code as defined in the Iowa Code. An individual who is claiming “surviving spouse” status for federal income tax purposes may not claim “head of household” on the Iowa individual income tax return.

39.4(8) Surviving spouse. The term “surviving spouse” shall have the same meaning as defined in the Internal Revenue Code. Individuals who qualify and file as a qualifying widow(er) with a dependent child on the federal return may file using the same filing status on the Iowa return.

This rule is intended to implement Iowa Code section 422.12.

701—39.5(422) Payment of tax.

39.5(1) Payment of tax for wage earners. Withholding of tax on wage earners is required under Iowa Code section 422.16. See 701—Chapter 46.

39.5(2) Payment of tax on income not subject to withholding. Those taxpayers with income not subject to withholding which will produce a tax liability of \$50 or more, shall file and pay a declaration of estimated tax. See 701—Chapter 47 of the rules.

39.5(3) Full estimated payment on original due date. When an extension is requested as provided by Iowa Code section 422.21, the total amount of estimated tax must be paid on or before the due date for filing the return.

39.5(4) Balance of tax due. If the computation on the tax return shows additional tax due, it shall be paid in full with the filing of the return.

39.5(5) Payment of tax by uncertified checks. The department will accept uncertified checks in payment of income taxes, provided the checks are collectible for their full amount without any deduction for exchange or other charges. The date on which the department receives the check will be considered the date of payment, so far as the taxpayer is concerned, unless the check is returned dishonored. If one check is remitted to cover two or more individuals’ taxes, the remittance must be accompanied by a letter of transmittal stating: (a) the name of the drawer of the check; (b) the amount of the check; (c) the amount of any cash, money order or other instrument included in the same remittance; (d) the name of each individual whose tax is to be paid by the remittance; and (e) the amount of payment on account of each individual.

39.5(6) Procedure with respect to dishonored checks. If any check is returned unpaid, all expenses incidental to the collection thereof will be charged to the taxpayer. If any taxpayer whose check has been returned by the depository bank uncollected should fail at once to make that check good, the director will proceed to collect the tax as though no check has been given. A taxpayer who tenders a certified check in payment for taxes is not relieved from obligation until the check has been paid.

39.5(7) Penalty and interest. In computing penalty and interest for failing to file a timely return or to pay the tax, refer to 701—Chapter 44.

39.5(8) Five thousand dollar exemption. This subrule is applicable to all taxpayers for tax years beginning on or after January 1, 1979, and before January 1, 1987. For tax years beginning on or after January 1, 1987, but before January 1, 1992, this subrule applies only to single taxpayers. Individuals whose net income, as computed under Iowa Code section 422.7, plus the amount of a lump sum distribution for which the taxpayer has elected to be separately taxed for federal income tax purposes, is \$5,000 or less are exempt from paying Iowa individual income tax subject to the following conditions:

a. Incomes of both husband and wife are considered in determining the exemption. The combined income regardless of filing status must be \$5,000 or less in order to qualify for the exemption.

b. An individual, claimed as a dependent on another person's return, with an income of at least \$3,000, but no more than \$5,000, will be exempt from Iowa tax if:

(1) The person on whose return the dependent is claimed has a net income of \$5,000 or less (\$7,500 or less for tax years beginning on or after January 1, 1987, but before January 1, 1992), or

(2) The person on whose return the dependent is claimed and the person's spouse have a combined net income of \$5,000 or less (\$7,500 or less for tax years beginning on or after January 1, 1987, but before January 1, 1992).

If the payment of tax would reduce the net income to less than \$5,000, the tax shall be reduced to that amount which would allow the taxpayer to retain a net income of \$5,000. For example: If a taxpayer's net income is \$5,025, and the computed tax after personal exemption and out-of-state credit is \$45, the payment of \$45 would reduce the net income below \$5,000; therefore, the amount of tax due is reduced to \$25 which enables the taxpayer to retain a net income of \$5,000.

This provision for reducing tax does not apply for the Iowa minimum tax.

c. For tax years beginning on or after January 1, 1988, but before January 1, 1991, a taxpayer's net income shall include any tax-exempt pensions, annuities, or retirement allowances for public employees described in rule 701—40.4(422) for purposes of determining whether the taxpayer is exempt from state income tax under the \$5,000 or less provision.

39.5(9) Seven thousand five hundred dollar exemption. For tax years beginning on or after January 1, 1987, but before January 1, 1992, all taxpayers, except single taxpayers described in subrule 39.4(1), whose net income as computed under Iowa Code section 422.7, plus the amount of a lump sum distribution for which the taxpayer has elected to be separately taxed for federal income tax purposes, is \$7,500 or less, are exempt from paying Iowa individual income tax subject to the following conditions:

a. Incomes of both husband and wife are considered in determining the exemption. The combined income regardless of filing status must be \$7,500 or less in order to qualify for the exemption. Subrule 39.5(9), paragraph "c," is applicable for taxpayers where one spouse has a net operating loss and the taxpayers file separate Iowa returns or separately on the combined return form.

b. An individual claimed as a dependent on another person's return with an income of at least \$3,000, but not more than \$7,500, will be exempt from Iowa tax if:

- (1) The person on whose return the dependent is claimed has a net income of \$7,500 or less, or
- (2) The person on whose return the dependent is claimed and the person's spouse have a combined net income of \$7,500 or less.

If the payment of tax would reduce the net income to less than \$7,500, the tax shall be reduced to that amount which would allow the taxpayer to retain a net income of \$7,500. For example: If a taxpayer's net income is \$7,525, and the computed tax after personal exemption and out-of-state credit is \$45, the payment of \$45 would reduce the net income below \$7,500; therefore, the amount of tax due is reduced to \$25 which enables the taxpayer to retain a net income of \$7,500.

This provision for reducing tax does not apply to the Iowa minimum tax.

c. For tax years beginning on or after January 1, 1988, but before January 1, 1991, the taxpayer's net income shall include any tax-exempt pensions, annuities, or retirement allowances for public employees described in rule 701—40.4(422) for purposes of determining whether the taxpayer or taxpayers are exempt from state income tax under the \$7,500 or less provision.

d. The \$7,500 or less exemption from tax does not apply to married taxpayers filing separate returns or filing separately on a combined return in cases where one of the spouses has a net operating loss and elects to carry back or carry forward that loss as provided in Iowa Code section 422.9, subsection 3, and in rule 701—40.18(422). Taxpayers making this election must submit a statement advising the department of the election with their return. When separate returns are filed, election statements must be provided with both returns.

EXAMPLE 1. Taxpayers filed a combined Iowa return for 1987. One of the spouses had a net income of \$22,500. The other spouse had a net operating loss of \$15,000. The spouse with the net operating loss elected to carry this net operating loss to the 1988 tax year. Therefore, although the taxpayers have a combined net income of \$7,500 or less, they did not qualify for exemption from tax since the taxpayers elected to carry forward the net operating loss.

EXAMPLE 2. Taxpayers filed a combined Iowa return for 1987. One spouse had a net operating loss of \$10,000. The second spouse had a net income of \$16,800. The taxpayers attached a statement with their return which indicated that the net operating loss would not be carried over or carried back. Since the taxpayers' combined income was \$7,500 or less and they chose not to carry back or carry forward the net operating loss, the taxpayers qualified for exemption from tax under the \$7,500 or less exemption.

39.5(10) *Eleven thousand five hundred dollar exemption and thirteen thousand five hundred dollar exemption.* For tax years beginning on or after January 1, 1993, all taxpayers except single taxpayers described in subrule 39.4(1), whose net income as computed under Iowa Code section 422.7, plus the amount of a lump sum distribution for which the taxpayer has elected to be separately taxed for federal income tax purposes, is \$13,500 or less (\$11,500 or less for tax years beginning in the 1992 calendar year), are exempt from paying Iowa individual income tax subject to the following conditions:

a. In the case of married taxpayers, the incomes of both spouses are considered in order to determine if the taxpayers qualify for exemption from tax. However, in the case of married taxpayers where one spouse has a net operating loss and the taxpayers file separate Iowa returns or separately on the combined return form, the taxpayers cannot receive the benefit of the exemption from tax if the spouse with the loss elects to carry back or carry forward that loss.

b. An individual claimed as a dependent on another person's return with an income of at least \$3,000, but not more than \$13,500 (\$11,500 for tax years beginning in 1992), will be exempt from Iowa tax if:

(1) The person on whose return the dependent is claimed is filing as a single individual and has a net income of \$9,000 or less (\$7,500 or less for tax years beginning in 1992), or

(2) The person on whose return the dependent is claimed and the person's spouse have a combined net income of \$13,500 or less (\$11,500 or less for tax years beginning in 1992).

(3) The person on whose return the dependent is claimed is filing as an unmarried head of household or as a surviving spouse and has a net income of \$13,500 or less (\$11,500 or less for tax years beginning in 1992).

c. If the payment of tax would reduce the net income to less than \$13,500 (\$11,500 or less for tax years beginning in 1992), the tax shall be reduced to an amount which would allow the taxpayer to retain a net income of \$13,500 (\$11,500 for tax years beginning in 1992). For example: If a taxpayer's net income was \$13,600 and the computed tax after personal exemptions and other credits was \$300, the payment of \$300 would reduce the income below \$13,500; therefore, the amount of tax is reduced to \$100 so the taxpayer can retain a net income of \$13,500.

39.5(11) *Seven thousand five hundred dollar exemption and nine thousand dollar exemption.* For tax years beginning on or after January 1, 1993, single taxpayers described in subrule 39.4(1), whose net income as computed under Iowa Code section 422.7, plus the amount of a lump sum distribution for which the taxpayer has elected to be separately taxed for federal income tax purposes is \$9,000 or less (\$7,500 or less for tax years beginning in the 1992 calendar year), are exempt from paying Iowa individual income tax subject to the following conditions:

a. An individual claimed as a dependent on another person's return with an income of at least \$3,000 but not more than \$9,000 (\$7,500 for tax years beginning in 1992) will be exempt from tax if:

(1) The person on whose return the dependent is claimed has a net income of \$9,000 or less (\$7,500 or less for tax years beginning in 1992), or

(2) The person on whose return the dependent is claimed and the person's spouse have a combined net income of \$13,500 or less (\$11,500 or less for tax years beginning in 1992).

(3) The person on whose return the dependent is claimed is filing as an unmarried head of household or as a surviving spouse and has a net income of \$13,500 or less (\$11,500 or less for tax years beginning in 1992).

b. If the payment of tax would reduce the net income to less than \$9,000 (\$7,500 for tax years beginning in 1992), the tax is reduced to an amount which will allow the taxpayer to retain a net income of \$9,000 (\$7,500 for tax years beginning in 1992).

This rule is intended to implement Iowa Code sections 422.5, 422.16, 422.17, 422.21, 422.24, and 422.25.

701—39.6(422) Minimum tax.

39.6(1) *Minimum tax for tax years beginning on or after 1982, but before 1985.* For tax years beginning on or after January 1, 1982, but before January 1, 1985, an Iowa minimum tax is imposed in addition to the tax computed under Iowa Code section 422.5. The Iowa minimum tax on tax preference items is a percentage of the state's apportioned share of the federal minimum tax(es) on tax preference items. For residents, the state's apportioned share of the federal minimum tax is 100 percent. For part-year residents and nonresidents, see paragraph "c" below. "Federal minimum tax" means the federal minimum tax(es) for tax preferences computed under Sections 55 to 58 of the Internal Revenue Code for the tax year. No estimate payments are required for minimum tax. No Iowa minimum tax will be imposed except to the extent the federal minimum tax is based on tax preference items as defined in Sections 55 to 58 of the Internal Revenue Code.

a. *Five thousand dollar exemption.* The Iowa minimum tax is imposed without regard to the exemption from paying Iowa income tax under Iowa Code section 422.5 given to individuals whose net income as computed under Iowa Code section 422.7 is \$5,000 or less. The Iowa minimum tax is not a payment of tax for purposes of the provisions of Iowa Code section 422.5 which limits the amount of tax on incomes slightly above \$5,000 to the amount the income exceeds \$5,000. The minimum tax may reduce the income to less than \$5,000.

b. *Married filing separately.* When a married couple files a joint federal return and elects to file separate Iowa income tax returns, the Iowa minimum tax shall be allocated between spouses in the ratio of the net income of each spouse to the total net income of both spouses, unless an alternative formula more accurately reflects the amount of Iowa minimum tax to be paid by each spouse.

c. *Part-year residents and nonresidents.* For part-year resident and nonresident taxpayers, the Iowa minimum tax is a percentage of the federal minimum tax times the ratio of the net income allocable to Iowa under Iowa Code section 422.8 to the federal adjusted gross income, unless the taxpayer can show that an alternative formula more accurately reflects the amount of minimum tax attributable to Iowa.

d. *Penalty and interest.* In computing penalty and interest for failing to file a timely return or to pay the minimum tax, refer to 701—Chapter 44.

e. *Personal exemption credits.* Personal and dependent exemption credits may be applied against the separate minimum tax to the extent that the credits are not fully applied against the computed tax on income reported under Iowa Code section 422.7.

f. *Minimum tax rates.* For tax years beginning on or after January 1, 1982, and prior to January 1, 1983, the Iowa minimum tax is 25 percent of the state's apportioned share of the federal minimum tax on tax preference items.

For tax years beginning on or after January 1, 1983, but before January 1, 1985, the Iowa minimum tax is 70 percent of the state's apportioned share of the federal minimum tax on tax preference items.

g. *Exclusion of gains or losses from distressed sales.* For tax years beginning on or after January 1, 1984, but before January 1, 1985, gains or losses from distressed sales transactions must be from the forfeiture of an installment real estate contract, the transfer of property in cancellation of a debt or from the sale or exchange of property as a result of actual notice of foreclosure and the taxpayer must meet the following two additional qualifications. Immediately before the forfeiture, transfer, sale or exchange, the taxpayer's accrued liabilities must have exceeded the fair market value of the taxpayer's assets. At the end of the tax year, the taxpayer's net worth must have been less than \$100,000. Taxpayers who file returns or amended returns for years beginning in 1984 and who claim exclusion of a gain or loss because of a distressed sale must provide documentation with their returns to show they met the distressed sale qualifications. The taxpayers should attach to their returns notice of foreclosure, proof of bankruptcy or any other document which would show a creditor's intention to foreclose. The taxpayers should also attach to their returns balance sheets showing net worth immediately before the forfeitures, transfers, sales or exchanges as well as balance sheets showing net worth at the end of the tax years. The balance sheets should include all the taxpayer's assets and liabilities and not just the assets and liabilities that relate to the taxpayer's farm or other business. The liabilities on the balance sheet shall be shown on an accrual basis. The assets should be shown on a fair market value basis, whether the balance sheet is prepared to show net worth immediately before the distressed sale or at the end of the tax year. Balance sheets should be on forms prescribed by the department.

The requirement for a taxpayer to provide a balance sheet with the return to show the taxpayer's net worth immediately before each distressed sale transaction is waived for those distressed sale transactions covered under a plan for dissolution of the assets of a farm or other business, except for the first distressed sale in the tax year covered by the dissolution plan. A copy of the dissolution plan is also required to be provided with the return.

h. Minimum tax on distressed sales limited to taxpayer's net worth immediately before the distressed sale. For tax years beginning in 1984, taxpayers who have a gain or loss from a distressed sale and who have a positive net worth immediately before the distressed sale shall be subject to minimum tax in an amount not to exceed the taxpayer's net worth. For purposes of this provision, a distressed sale is the forfeiture of an installment real estate contract, or the transfer of property to a creditor in cancellation of a debt or from the sale or exchange of property as a result of actual notice of foreclosure. The taxpayer should attach a document to the return to verify that the gain or loss was from a distressed sale. Proof of the forfeiture of the installment real estate contract, proof of transfer of property in cancellation of a debt, proof of bankruptcy or a copy of the notice of forfeiture will constitute documentation of the distressed sale. The balance sheet showing the taxpayer's net worth immediately before the distressed sale should also be provided with the return.

In the case of a taxpayer who had two or more distressed sale transactions in the tax year and had a positive net worth immediately before each transaction, the taxpayer's minimum tax liability would be limited to the net worth immediately before the last distressed sale transaction in the tax year.

The balance sheets supporting the taxpayer's net worth should include the taxpayer's personal assets and liabilities as well as the assets and liabilities of the taxpayer's farm or other business.

39.6(2) *Minimum tax for tax years beginning on or after January 1, 1985, but before January 1, 1987.*

a. New method for computation of the minimum tax. For tax years beginning on or after January 1, 1985, but before January 1, 1987, the minimum tax is imposed only to the extent that the minimum tax exceeds the taxpayer's regular income tax liability. The minimum tax rate is 9 percent of minimum taxable income. Minimum taxable income is computed as follows:

	Iowa Taxable Income
Plus:	<u>*Tax Preference Items (from Form 6251)</u>
	Subtotal
Less:	<u>**Applicable Exemption Amount</u>
	Minimum Taxable Income

*For tax years beginning in 1985, the tax preference items used in computing state minimum tax are the same preference items provided in Section 57a of the Internal Revenue Code which are used in computing the federal minimum tax. These tax preference items are:

- (1) Dividend exclusion
- (2) Accelerated depreciation on nonrecovery real property
- (3) Accelerated depreciation on leased personal property
- (4) Amortization of certified pollution control facilities
- (5) Mining, exploration, and development costs
- (6) Circulation and research and experimental expenditures

- (7) Reserves for losses on bad debts of financial institutions
- (8) Depletion
- (9) Capital gains deduction
- (10) Incentive stock options
- (11) Intangible drilling costs
- (12) Accelerated cost recovery deduction

For tax years beginning on or after January 1, 1986, but before January 1, 1987, all the tax preference items shown above are applicable for state minimum tax purposes except for depletion (39.6(2) “a”(8)) and intangible drilling costs (39.6(2) “a”(11)). There is an additional tax preference item for excessive passive activity losses which is described in subrule 39.6(2), paragraph “f.”

**Exemption amounts are: \$17,500 for a married person filing a separate return or separately on the combined return form or for an estate or trust; \$26,000 for a single person or an unmarried head of household or qualifying widow(er); \$35,000 for a married couple filing a joint return.

The following two examples illustrate how the minimum tax is computed for tax years beginning on or after January 1, 1985, but before January 1, 1987:

EXAMPLE 1. Taxpayers A had an Iowa income tax liability of \$10,616 from a taxable income of \$100,000 in 1985. The A’s were filing a joint return and had tax preferences of \$60,000 from a capital gain deduction. The A’s minimum tax liability is shown below:

	Iowa Taxable Income	\$100,000
Plus:	Tax Preference Item	<u>60,000</u>
	Subtotal	160,000
Less:	Exemption Amount	<u>35,000</u>
	Minimum Taxable Income	\$125,000
		<u>× .09</u>
	Computed Minimum Tax	\$ 11,250
Less:	Regular Tax	<u>10,616</u>
	Minimum Tax Liability	\$ 634

Since the A’s minimum tax exceeded their regular tax by \$634, their minimum tax liability is \$634.

EXAMPLE 2. The B’s are filing their 1985 Iowa return. They had a regular income tax liability of \$10,616 on their taxable income of \$100,000. The B’s had a tax preference of \$50,000 from a capital gain deduction. The B’s minimum tax liability is shown below:

	Iowa Taxable Income	\$100,000
Plus:	Tax Preference Item	<u>50,000</u>
	Subtotal	150,000
Less:	Exemption Amount	<u>35,000</u>
	Minimum Taxable Income	115,000
		<u>× .09</u>
	Computed Minimum Tax	\$ 10,350

Because the computed minimum tax of \$10,350 was less than the B’s regular income tax liability of \$10,616, the B’s are not subject to minimum tax on their 1985 return.

b. Exclusion of gains or losses from distressed sales for purposes of the minimum tax. Taxpayers with gains or losses from sales, exchanges or transfers of property may exclude those gains or losses for purposes of the minimum tax if those gains or losses were from sales, exchanges, forfeitures or transfers of property that are considered to be distressed sales.

(1) Qualifications that must be met for transactions to be considered to be distressed sales. There are a number of qualifications that must be met before a transaction can be considered to be a distressed sale so that the gain or loss from the transaction is excluded from the minimum tax. In order for a transaction to be considered a distressed sale transaction it must involve the forfeiture of an installment real estate contract, or the transfer of real or personal property securing a debt to a creditor in cancellation of that debt, or from the sale or exchange of property as a result of an actual notice of foreclosure from a creditor. The following three additional conditions had to have been met before a transaction would be considered to be a distressed sale transaction:

1. The forfeiture, transfer, sale or exchange of property had to have been made for the purpose of establishing a positive cash flow.

2. Immediately before the forfeiture, transfer, sale or exchange, the taxpayer's debt to asset ratio exceeded 75 percent as computed under generally accepted accounting principles.

3. The taxpayer's net worth at the end of the tax year was less than \$75,000.

For purposes of computation of the debt to asset ratio in subparagraph (2) and the net worth in subparagraph (3) the taxpayer's personal assets and liabilities must be considered as well as the assets and liabilities of the taxpayer's farm or other business. The assets must be shown at their fair market value which is the price at which the property would change hands between a willing buyer and willing seller, neither party being required to buy or sell and both parties having all the facts necessary to the transaction.

The assets for purposes of computing the debt to asset ratio and the net worth are to include any assets transferred within 120 days of the distressed sale transaction or within 120 days of the end of the year, where the assets transferred were done so without adequate and full consideration in money or money's worth.

(2) Documentation needed by a taxpayer to establish that a gain or loss was from a distressed sale. The burden of proof is on the taxpayer to establish that the gain or loss from a forfeiture, transfer, sale or exchange of an asset was a distressed sale, so the gain or loss would be excluded from the minimum tax. The taxpayer should attach to the return documents which would prove that the requirements and conditions of the distressed sale were satisfied. The taxpayer should attach a balance sheet to the return to show the taxpayer's debt to asset ratio immediately before each distressed sale transaction as well as a balance sheet to establish the taxpayer's net worth at the end of the tax year. In addition, the taxpayer should provide copies of any documents which would show that a transfer, forfeiture, sale or exchange was a distressed sale transaction. Examples of these documents would include a notice of forfeiture, proof of bankruptcy or evidence showing that a transfer, sale or exchange was made to generate a positive cash flow. Balance sheets should be on forms prescribed by the department.

The requirement for a taxpayer to provide a balance sheet with the return to show the taxpayer's net worth immediately before each distressed sale transaction is waived for those distressed sale transactions covered under a plan for dissolution of the assets of a farm or other business, except for the first distressed sale in the tax year covered by the dissolution plan. A copy of the dissolution plan is also required to be provided with the return.

c. *Net operating losses carried back or carried forward to tax year with tax preference items.* Net operating losses which are carried back or carried forward to a tax year with tax preference items will be used to decrease minimum taxable income as described in paragraph "a" above. However, in the case of a net operating loss computed for a year beginning after 1982 which is carried to another year after 1982, the net operating loss to be applied to minimum taxable income will be reduced by the amount of tax preference items used to compute the net operating loss.

When a net operating loss is carried forward or carried back to the current tax year and is applied to the minimum tax liability, any portion of the net operating loss which exceeds minimum taxable income may be carried over to the subsequent year. However, the amount to be carried over may not exceed any amount that is carried over after the net operating loss is applied to regular taxable income.

d. *Minimum tax on distressed sales limited to taxpayer's net worth immediately before the distressed sale.* Taxpayers that have sales, forfeitures, transfers or exchanges of property that qualify as distressed sales may limit their minimum tax liabilities to their net worths immediately prior to the distressed sales. For purposes of this provision, a distressed sale is the forfeiture of an installment real estate contract, or the transfer of property to a creditor in cancellation of a debt or from the sale or exchange of property as a result of actual notice of foreclosure. Proof of forfeiture of the installment estate contract, proof of transfer of property in cancellation of a debt or a copy of the notice of forfeiture will constitute documentation of the distressed sale and should be made a part of the return. A copy of the balance sheet showing the taxpayer's net worth immediately before the distressed sale should also be provided with the return. Any asset transferred within 120 days of the distressed sale without proper consideration should be considered in the taxpayer's net worth computation.

The balance sheet supporting the taxpayer's net worth should include the taxpayer's personal assets and liabilities as well as the assets and liabilities of the taxpayer's farm or other business.

e. *Election for taxpayers with long-term capital gain transactions occurring between January 1, 1985, and May 1, 1985.* Taxpayers that have a long-term capital gain transaction in the period between January 1, 1985, and May 1, 1985, may elect to be subject to minimum tax for the 1985 tax year under the minimum tax law which was in effect prior to the 1985 tax year. Therefore, taxpayers that make this election will be subject to minimum tax on the basis of 70 percent of their federal minimum tax liabilities. These taxpayers should attach a copy of the federal minimum tax form to support their federal minimum tax liabilities for 1985.

Individuals who elect to pay minimum tax for 1985 under the prior law that have capital gains or losses from distressed sales as described in subrule 39.6(2), paragraph "b," may not exclude those gains or losses for purposes of the minimum tax. In addition, taxpayers who make the election and have capital gains or losses from distressed sales may not limit their minimum tax liabilities to net worth immediately before the distressed sale as outlined in subrule 39.6(2), paragraph "d."

f. *Excessive passive activity losses.* For tax years beginning on or after January 1, 1986, but before January 1, 1987, the amount of the loss from excessive passive activities is a tax preference item for state minimum tax purposes as computed in 39.6(2), paragraph "a." Therefore, to the extent that the amount of losses from passive activities is excessive, the losses are added to taxable income to determine minimum taxable income.

The amount of excessive passive activity losses is the amount by which the aggregate losses from all passive activities, reduced by the aggregate income from passive activities, exceed the sum of the taxpayer's cash basis in passive activities which are not tax shelters plus the lesser of the taxpayer's cash basis in passive activities which are tax shelters or \$50,000.

A loss incurred from a farming business, as defined in Section 464(e) of the Internal Revenue Code, will not be considered for purposes of this paragraph to the extent that the loss is used in computing net income under Iowa Code section 422.7 and in rule 701—40.28(422).

For purposes of this paragraph, the following definitions and provisions apply:

- (1) “Tax shelter” means the same as is defined in Section 461(i)(3) of the Internal Revenue Code.
- (2) “Passive activity” means an activity where a substantial portion of the income is from a trade or business. Rents or royalties are income from a trade or business. An activity which derives income in the form of capital gains, dividends, or interest will not be considered to be a passive activity unless it also derives a substantial portion of its income from a trade or business.

The substantiality of income derived from trade or business activities is generally determined in a gross receipts sense. Therefore, an activity with substantial business sales, but which lost money on these sales, generally would be treated as having substantial trade or business income.

“Passive activity” means an activity where the taxpayer or a member of the taxpayer’s family as defined in Section 2032A(e)(2) of the Internal Revenue Code does not materially participate in the activity or provide substantial personal services to the activity. However, a taxpayer who is retired or disabled as described in Section 2032A(b)(4) of the Internal Revenue Code or is a surviving spouse as described in Section 2032A(b)(5) of the Internal Revenue Code will be considered to be materially participating in an activity unless the individual is a limited partner in the activity.

Investing in a limited partnership, grantor trust, or S corporation, or serving as a “silent” partner in a general partnership where the taxpayer’s involvement is limited to financing the enterprise are considered to be examples of “passive activities” for a taxpayer. However, where the taxpayer owns an interest in a business directly, the fact that an agent may be employed to collect rents will not cause the activity to be considered passive where the taxpayer oversees the activity and actively participates in decision making.

In addition, an activity conducted by an individual may be excluded from treatment as a passive activity even if the person does not participate in management, if the taxpayer provides substantial personal services with respect to the activity.

- (3) “Cash basis” means in the case of an interest in a partnership, the adjusted basis of the taxpayer’s interest determined without regard to any liability of or amount borrowed by the partnership with respect to the partnership which was secured by any assets of the partnership. In all other cases, the adjusted basis of the taxpayer’s interest is to be determined under principles relating to the case of a partnership.

- (4) A loss from any activity will be determined under the principles of Section 465(d) of the Internal Revenue Code, except to the extent that any deduction is an item of tax preference for purposes of subrule 39.6(2), paragraph “a,” that deduction will not be taken into account.

- (5) A loss from an activity that is disallowed and included as a tax preference item for minimum tax purposes under this paragraph can be treated as an allowable deduction in the next tax year for the same activity.

- (6) If the taxpayer disposes of the taxpayer’s entire interest in a passive activity during the tax year, the amount of loss attributed to the activity determined after carryovers in subrule 39.6(2), paragraph “f,” subparagraph (5), will be allowed in computing minimum taxable income but will not be treated as a loss for purposes of this paragraph.

(7) Examples. The examples shown below illustrate how the amount of excess passive activity losses is to be computed:

EXAMPLE A. A taxpayer has a \$60,000 loss from passive investments in tax shelters. The taxpayer had a \$20,000 cash basis in these passive activities. The income from passive activities and the cash basis in passive activities which were not tax shelters are both \$0. The taxpayer may use the \$20,000 basis to calculate the amount of the preference, since the cash basis was \$20,000 and the loss is limited to the lesser of the basis or \$50,000. The taxpayer has a tax preference of \$40,000. The taxpayer may carry over the \$40,000 tax preference as a loss to the subsequent tax year for purposes of calculating the tax preferences for that year.

EXAMPLE B. A taxpayer had a loss of \$160,000 from passive activities in tax shelters and had a cash basis of \$120,000 in these passive activities. The income from passive activities and the cash basis in passive activities which were not tax shelters are both \$0. The taxpayer is limited to using \$50,000 in calculating the amount of the preference since the cash basis was greater than \$50,000. The tax preference was \$110,000 which provides a carryover loss of \$110,000 for purposes of calculating the tax preference for the subsequent tax year.

EXAMPLE C. A taxpayer had a loss of \$140,000 from all passive activities. This taxpayer had a cash basis of \$70,000 in passive activities which are not tax shelters and a cash basis of \$60,000 in passive activities which are tax shelters. The taxpayer has a tax preference of \$20,000 which may be carried over to the subsequent tax year for purposes of calculation of the tax preference for that tax year. The taxpayer is allowed the loss to the full extent of the cash basis in passive activities which are not tax shelters of \$70,000 and is allowed another \$50,000 of the loss to the extent of \$50,000 of the cash basis in passive activities which are tax shelters.

EXAMPLE D. A taxpayer had \$25,000 losses from each of four passive activities. Therefore, the aggregate losses from all passive activities was \$100,000. The taxpayer had incomes of \$12,000, \$13,000, and \$10,000 from passive activities. Therefore, the aggregate income from passive activities was \$35,000. The taxpayer's cash basis in each of two passive activities which were not tax shelters was \$10,000 each. Therefore, the cash basis in passive activities which were not tax shelters was \$20,000. The taxpayer's cash basis in each of six passive activities which were tax shelters was \$5,000 each. Therefore, the cash basis in passive activities was \$30,000 (less than \$50,000). The calculation for the amount of the tax preference is: $(\$100,000 - \$35,000) - (\$20,000 + \$30,000) = \$15,000$. The tax preference of \$15,000 may be carried forward to the subsequent tax year for purposes of calculation of the tax preference for the subsequent tax year.

39.6(3) Minimum tax for tax years beginning on or after January 1, 1987.

a. *Method for computation of the minimum tax.* For tax years beginning on or after January 1, 1987, the minimum tax is imposed only to the extent that the minimum tax exceeds the taxpayer's regular income tax liability. The minimum tax rate is 75 percent of the maximum regular tax rate for individual income tax. For tax years beginning on or after January 1, 1987, through December 31, 1997, the tax rate is 7.5 percent of the taxpayer's minimum taxable income. For tax years beginning on or after January 1, 1998, the tax rate is 6.7 percent of the taxpayer's minimum taxable income. Minimum taxable income is computed as follows:

	Iowa Taxable Income
Plus:	<u>*Applicable Adjustments and **Tax Preference Items (from Form IA 6251)</u>
	Subtotal
Less:	<u>***Applicable Exemption Amount</u>
	Minimum Taxable Income

*The federal adjustments that are also applicable in computing state minimum taxable income are:

- (1) Depreciation of property placed in service after 1986
- (2) Circulation and research and experimental expenditures paid or incurred after 1986
- (3) Mining, exploration, and development costs paid or incurred after 1986
- (4) Long-term contracts entered into after 2-28-86
- (5) Pollution control facilities placed in service after 1986
- (6) Installment sales of certain property
- (7) Basis adjustment
- (8) Certain loss limitations
- (9) Tax shelter farm loss
- (10) Passive activity loss
- (11) Adjustments related to beneficiaries of estates and trusts.

**The federal tax preference items which are also applicable in computing state minimum taxable income are:

- (1) Accelerated depreciation of real property placed in service before 1987
- (2) Accelerated depreciation on leased personal property placed in service before 1987
- (3) Amortization of certified pollution control facilities placed in service before 1987
- (4) Appreciated property charitable deduction
- (5) Incentive stock options
- (6) Reserves for losses on bad debts of financial institutions.

Note that in the case of taxpayers that file claims for the special refunds described in rule 701—43.7(422) for tax years beginning in 1987, the capital gain deductions determined for purposes of the special refunds are tax preference items for state minimum tax purposes.

***Exemption amounts are: \$17,500 for a married person filing a separate return or separately on the combined return form or for an estate or trust; \$26,000 for a single person or an unmarried head of household or qualifying widow(er); \$35,000 for a married couple filing a joint return. However, the applicable exemption amounts will be reduced, but not below zero, by 25 percent of the amount by which the minimum taxable income of the taxpayer determined without the exemption amount exceed the following amounts: \$75,000 for a married taxpayer filing separate returns or separately on the combined return or for an estate or a trust; \$112,500 for a single person, an unmarried head of household, or a surviving spouse (qualifying widow(er)); \$150,000 for a married couple that files a joint state return.

The following two examples illustrate how the minimum tax is computed for tax years beginning on or after January 1, 1987:

EXAMPLE 1. Taxpayers A had an Iowa income tax liability of \$9,375 from a taxable income of \$100,000 in 1987. The A's were filing a joint return and had tax preferences of \$60,000 from an appreciated property charitable deduction. The A's minimum tax liability is shown below:

	Iowa Taxable Income	\$100,000
Plus:	Tax Preference Items and Adjustments	<u>60,000</u>
	Subtotal	160,000
Less:	Exemption Amount	<u>35,000</u>
	Minimum Taxable Income	\$125,000
		<u>× .075</u>
	Computed Minimum Tax	\$ 9,375
Less:	Regular Tax	<u>8,648</u>
	Minimum Tax Liability	\$ 727

Since the A's minimum tax liability exceeded their regular tax by \$727, they had a minimum tax liability of \$727 in 1987.

EXAMPLE 2. Ms. B was a single taxpayer in 1987. She had a regular income tax liability of \$9,375 on taxable income of \$100,000. She had an adjustment of \$50,000 from a passive activity loss. Ms. B's minimum tax liability is shown below:

	Iowa Taxable Income	\$100,000
Plus:	Tax Preference Items and Adjustments	<u>50,000</u>
	Subtotal	\$150,000
Less:	Exemption Amount	<u>35,000</u>
	Subtotal	\$115,000
Plus:	Reduction in Exemption Amount (25% of \$37,500)	<u>9,375</u>
	Minimum Taxable Income	\$124,375
		<u>× .075</u>
	Computed Minimum Tax	\$ 9,328
Less:	Regular Tax	<u>8,648</u>
	Minimum Tax Liability	\$ 680

Ms. B had a minimum tax liability of \$680 in 1987 because the minimum tax exceeded the regular tax for 1987 by \$680.

b. *Net operating loss computed for a year beginning after 1982 which is carried back or carried forward to the current taxable year.* In the case of a net operating loss computed for a tax year beginning after December 31, 1982, which is carried back or carried forward to the current tax year, the net operating loss shall be reduced by the amount of the items of tax preference arising in the current tax year.

c. *Net operating loss deduction for tax years beginning after December 31, 1986.* The deduction for a net operating loss for a tax year beginning after December 31, 1986, which is carried back or carried forward to another tax year shall not exceed 90 percent of the minimum taxable income computed for the tax year without the net operating loss. The computation of minimum taxable income is described in paragraph “a” of this subrule.

d. *Apportionment of minimum tax for nonresidents and part-year residents and nonresident and part-year resident estates or trusts.* In the case of resident taxpayers, including estates or trusts domiciled in Iowa for the entire tax year, the taxpayers are subject to 100 percent of the minimum tax computed as described in paragraph “a” of this subrule. In the case of nonresidents of Iowa including nonresident estates and trusts and individuals, including estates and trusts domiciled in Iowa for less than the entire tax year, the minimum tax computed according to paragraph “a” of this subrule less applicable credits against tax is allocated to Iowa as shown below:

State Minimum Tax
Less Credits

×

Iowa Source Net Income Plus Tax
Preferences, Adjustments and
Losses Attributable to Iowa

Total Net Income Plus All Tax
Preferences, Adjustments and Losses

For purposes of this computation, only those adjustments, tax preferences, and losses shown on Form IA 6251 are applicable for determining which items shall be included in the numerator and the denominator.

e. *Allocation of the state minimum tax between married couples filing separate returns or separately on the combined return form.* Married taxpayers electing to file separate returns or separately on the combined return form must allocate the minimum tax between them in the proportion that each spouse’s respective preference items, adjustments, and losses relate to the preference items, adjustments and losses of both spouses.

This rule is intended to implement Iowa Code section 422.5 as amended by 1997 Iowa Acts, House File 388.

701—39.7(422) Tax on lump-sum distributions. For tax years beginning on or after January 1, 1982, Iowa Code section 422.5 provides that in addition to the tax computed on the taxable income, a tax shall also be imposed on the amount of a lump-sum distribution for which the taxpayer has elected under Section 402(e) of the Internal Revenue Code to be separately taxed for federal income tax purposes for the tax year. The rate of this tax is 25 percent of the separate federal tax imposed on the amount of the lump-sum distribution.

39.7(1) Five thousand dollar exemption (\$7,500 exemption for all taxpayers except single taxpayers for tax years beginning on or after January 1, 1987). To be eligible for the \$5,000 or less exemption as provided in Iowa Code section 422.5, the total amount of a lump-sum distribution subject to the separate federal tax must be included in the net income. If this net income (including the lump-sum distribution income) is less than \$5,000, then no tax (other than Iowa minimum tax) is due. The Iowa tax on lump-sum distributions and the computed tax may be limited to the amount of income tax that exceeds \$5,000 (including the lump-sum income). Example: If the net income including a lump-sum distribution was \$5,030 and the computed tax and lump-sum tax was \$50 after personal exemptions and out-of-state credit, the payment of \$50 tax would reduce the income below \$5,000; therefore, the amount of tax due is reduced to \$30 which enables the taxpayer to retain a net income of \$5,000. Note that for tax years beginning on or after January 1, 1987, the \$5,000 or less exemption is increased to \$7,500 or less for all taxpayers except single taxpayers described in subrule 39.4(1).

39.7(2) Nonresidents. A nonresident is liable for tax on a lump-sum distribution or a portion of a lump-sum distribution attributable to services performed within Iowa. If a distribution to a nonresident is attributable to services performed both within and outside Iowa, the tax must be allocated in the ratio of the income from services performed within Iowa to the total income from all services performed relating to the lump-sum distribution unless it can be shown that another method of proration would result in a more equitable amount of tax on the distribution.

39.7(3) Penalty and interest. In computing penalty and interest for failing to file a timely return or to pay the lump-sum tax, refer to 701—Chapter 44.

39.7(4) Personal exemption credits. Personal and dependent exemption credits may be applied against the separate lump-sum tax to the extent that the credits are not fully applied against the computed tax on income reported under Iowa Code section 422.7.

39.7(5) Out-of-state tax credit. When computing an out-of-state tax credit for a year in which tax on a lump-sum distribution has been computed separately, the amount of the lump-sum distribution on which the separate tax has been computed must be included on the Iowa gross income.

This rule is intended to implement Iowa Code section 422.5.

701—39.8(422) State income tax limited to taxpayer's net worth immediately before the distressed sale. Taxpayers whose net incomes include gains or losses from distressed sales may limit their state income tax liabilities for the tax years in which the distress sales occurred to their net worths immediately before the distressed sales. The state income tax liability of a taxpayer is the aggregate of the taxpayer's income tax plus the taxpayer's minimum tax plus the taxpayer's lump-sum tax. For purposes of this provision, a distressed sale is the forfeiture of an installment real estate contract, the transfer of real or personal property securing a debt to a creditor in cancellation of that debt, or from the sale or exchange of property as a result of actual notice of foreclosure. Proof of forfeiture of the installment real estate contract, proof of transfer of property to a creditor in cancellation of a debt, or a copy of the notice of foreclosure will constitute documentation of the distressed sale and must be made a part of the return. A copy of the balance sheet showing the taxpayer's net worth immediately before the distressed sale must also be provided with the return.

The balance sheet supporting the taxpayer's net worth must include the taxpayer's personal assets and liabilities as well as the assets of the taxpayer's farm or other business. In the case of married taxpayers, except in the case of a husband and wife who lived apart at all times during the tax year, the assets and liabilities of both spouses must be considered in determining the taxpayers' net worth immediately before the distressed sale.

This rule is intended to implement Iowa Code section 422.5.

701—39.9(422) Special tax computation for all low-income taxpayers except single taxpayers.

For tax years beginning on or after January 1, 1987, a special tax computation is available for determining the state income tax liability for all low-income taxpayers except single taxpayers described in subrule 39.4(1). Under this provision, the taxpayer multiplies the net income for the tax year in excess of \$7,500 (net income in excess of \$11,500 for tax years beginning in 1992) or (net income in excess of \$13,500 for tax years beginning on or after January 1, 1993) by the maximum individual income tax rate. The tax amount computed by this procedure is then compared to the tax amount on the individual's taxable income from the tax tables or the tax-rate schedule. The taxpayer is subject to the lesser of the two tax amounts. In the case of married taxpayers electing to file separate returns or separately on the combined return form, the incomes of both spouses must be considered for purposes of determining the tax liability from the special tax computation. The tax liability calculated from the special tax computation is allocated between the spouses in the ratio of each spouse's net income to the combined net income of both spouses.

For example, a married couple's net income in 1987 was \$8,200. The taxpayers elected to file separately on the combined return form for 1987. One spouse had a net income of \$6,000, the second spouse had a net income of \$2,200. There was no federal income tax withheld on the wages earned by either of the taxpayers. The spouse with the net income of \$6,000 had a regular income tax liability of \$105. The spouse with the net income of \$2,200 had a regular income tax liability of \$4. The special tax computation of these taxpayers is shown below:

	Taxpayers' combined net income	\$8,200
	(\$6,000 + \$2,200)	
Less:	Income not subject to special tax	<u>7,500</u>
	Income subject to special tax	700
		<u>× 9.98%</u>
	Special tax liability for 1987	\$ 70

The taxpayers' special tax liability for 1987 was \$70. The special tax is imposed since it is less than the taxpayers' regular tax liability of \$109. This special tax liability is allocated to each spouse on the following basis:

Spouse 1	Spouse 2
$\frac{\$6,000}{\$8,200} \times 70 = \$51$	$\frac{\$2,200}{\$8,200} \times 70 = \$19$

The special tax computation for low-income taxpayers is not available to married taxpayers filing separate state returns or to married taxpayers filing separately on the combined return form in instances where one of the spouses has a net operating loss described in Iowa Code section 422.9, subsection 3, and the spouse elects to carry back or carry forward the net operating loss.

This rule is intended to implement Iowa Code section 422.5.

701—39.10(422) Election to report excess income from sale or exchange of livestock due to drought in the next tax year. For tax years beginning on or after January 1, 1990, a taxpayer may elect to report excess income from the sale or exchange of livestock due to drought on the Iowa return for the next tax year if the taxpayer qualified for similar treatment of the excess income under Section 451(e) of the Internal Revenue Code. This election is available only to a taxpayer on the cash receipts and disbursements method of accounting whose principal trade or business is farming as described in Section 6420(c)(3) of the Internal Revenue Code. For purposes of this rule the election applies to all livestock held for sale or exchange, whether raised or purchased for resale. This election also applies to livestock used for draft, breeding, dairy, or sporting purposes which were held less than two years in the case of cattle and horses and less than one year in the case of other livestock. For purposes of this election, livestock does not include poultry.

The area in which the livestock was sold or exchanged must have been declared a disaster area due to drought. However, the sale or exchange can take place before or after the area is declared a disaster area as long as the same disaster (the drought) caused the livestock sale. In order for the election to report excess income in the following tax year to be valid, the election must be made by the due date of the return, including extensions. Additional information about computing the excess income as well as information needed on the statement for making the election is described in Treasury Regulation §1.451-7.

This rule is intended to implement Iowa Code section 422.5.

701—39.11(422) Forgiveness of tax for an individual whose federal income tax was forgiven because the individual was killed outside the United States due to military or terroristic action. For tax years ending on or after August 2, 1990, an individual's Iowa income tax is forgiven if the person's federal income tax was forgiven because the individual was killed in a combat zone, the individual was missing in action and presumed dead, or the individual was killed outside the United States due to terrorist or military action while the person was a military or civilian employee of the United States. The Iowa income tax is forgiven on the return for the tax year in which the individual was killed or was missing and was presumed dead, and is forgiven on the return for the tax year prior to the year of death. In a situation where the person that was killed was married at the time of death, no tax will be due on the return filed for the year of death if a joint state return or a married filing separately on the combined state return is filed for that tax year. In the case of the return for the tax year prior to the year of death for the person killed in military or terrorist action, all the tax will be forgiven on the return if the person was married at the time of death and a joint state return or a married filing separate state return was filed for this prior year. However, if the person that was killed had filed a return using the married filing separately on the combined return form status, only the state income tax attributable to the person that was killed will be forgiven. The department will not honor an amended return for the prior year to change the filing status from separately on the combined return form to joint return so all the state income tax for both spouses will be forgiven.

When a state income tax return or claim for refund is filed for forgiveness of tax for an individual who was killed in military or terrorist action, a notation should be entered at the top of the return "Forgiveness of Tax—Killed in Military Action" or "Forgiveness of Tax—Killed in Terrorist Action" depending on how the individual was killed. In addition, a copy of the death certificate, or other evidence of the person's death or evidence establishing that the individual is missing in action and presumed dead, should be attached to the claim for refund or the tax return. A refund claim for forgiveness of tax will be honored only if the claim is made within the statute of limitations for refund provided in Iowa Code subsection 422.73(2).

This rule is intended to implement Iowa Code sections 422.5 and 422.73.

701—39.12(422) Tax benefits for persons serving in the operation desert shield combat zone. For tax years ending after August 2, 1990, a number of state tax benefits are authorized for persons who served in the area designated by the President and the Congress in 1991 as a combat zone. Those persons who were in the combat zone in support of the armed forces personnel are also eligible for the tax benefits. The eligible individuals are given the same additional time period to file state income tax returns and perform other acts related to the department of revenue and finance as would constitute timely filing of returns or timely performance of other acts as described in Section 7508(a) of the Internal Revenue Code. "Other acts related to the department" includes filing claims for refund for any type of tax administered by the department, making tax payments other than withholding payments, filing appeals on tax matters, filing returns for taxes other than income tax, and performing other acts such as making timely contributions to individual retirement accounts. The additional time period for filing returns and performing other acts applies to the spouse of the person who was in the combat zone to the extent the spouse files jointly or separately on the combined return with the person who was in the combat zone, or when the spouse is a party with the person who was in the combat zone to any tax matter with the department for which the additional time period is allowed. For purposes of the tax benefits provided to persons in the combat zone, the Internal Revenue Code is to include the provisions in Public Law No. 102-2 which was enacted in January 1991. The additional time period for filing state returns and performing other acts is 180 days after the person leaves the combat zone which is the same time period as allowed in federal income tax law. However, a person who was hospitalized because of illness or injury in the combat zone has up to five years to file returns or perform certain acts with this department after leaving the combat zone.

For tax years beginning on or after January 1, 1995, certain persons performing peacekeeping duties in a location designated by Congress as a qualified hazardous duty zone or other individuals performing military duties overseas in support of the persons in the hazardous duty area are eligible for the tax benefits described above. See rule 39.14(422) for additional information on the hazardous duty area.

This rule is intended to implement Iowa Code sections 422.3 and 422.21 as amended by 1996 Iowa Acts, Senate File 2168.

701—39.13(422) Electronic filing of Iowa individual income tax returns. Effective for the 1994 calendar year and tax years beginning after December 31, 1994, individuals who meet qualifications set out by the department for the particular tax year may elect to file their Iowa income tax returns electronically. An electronically filed IA 1040, long form return, consists of electronically transmitted data and certain paper documents. For the 1994 and 1995 tax years, the paper documents were to be sent to the department with Form IA 8453 (Iowa Individual Income Tax Declaration for Electronic Filing). For the 1996 tax year and tax years after 1996, Forms IA 8453 and the attached paper documents are not to be sent to the department in situations where the Iowa individual income tax returns were filed electronically by an electronic filer who is authorized to file other persons' Iowa individual returns. The IA 8453 forms for these tax years must be retained by the electronic filer for at least three years after the due dates of the returns, or the dates the returns were filed electronically, whichever dates are the later dates. On the other hand, an individual taxpayer filing the taxpayer's Iowa return on an on-line basis for 1996 and subsequent tax years must still mail, fax, or deliver the IA 8453-OL and any attached documents (W-2s, 1099s, and out-of-state returns) to the department within one workday of receipt of the acknowledgement from the Internal Revenue Service that the federal return and state return for the taxpayer have been accepted. For purposes of this rule, all references to Form IA 8453 should also be considered to apply to Form IA 8453-OL (Iowa Individual Income Declaration For On-Line Service Electronic Filing) except those references which pertain to the retention of the Form IA 8453 by the electronic return originator (ERO).

A taxpayer's electronic Iowa return will include the same information as if the taxpayer had filed a paper Iowa return.

There is no statutory requirement which provides that individuals must file their Iowa income tax returns electronically. Therefore, Iowa taxpayers always have the option to file their Iowa income tax returns on the paper forms available from the department.

Upon request by the department of revenue and finance, the ERO is required to provide Form IA 8453 with all attachments to the department within five working days from the date of the request. In situations where the ERO moves, the ERO must inform the department of the address change for the ERO's office within 14 days of the change. In situations where an ERO ceases operation and has retained the IA 8453 forms for Iowa income tax returns which have been filed electronically for taxpayers, the ERO is to send to the department all the IA 8453 forms that are within three years of the due dates of the returns or the dates the returns were filed, whichever of the dates is later.

However, if for some reason an ERO is unable to retain IA 8453 forms for Iowa returns the ERO has filed electronically for taxpayers, the ERO may request permission to mail, fax, or bring the IA 8453 forms and attachments to the department. Examples of EROs who may be unable to retain IA 8453 forms are EROs assisting low-income and elderly taxpayers in filing Iowa returns electronically under the VITA/TCE program and EROs on military installations assisting Iowa residents in the armed forces in filing Iowa returns electronically.

All aspects of filing Iowa returns electronically are described in the following subrules:

39.13(1) *Participants in electronic filing of Iowa individual income tax returns.* “Electronic filers” are individuals or companies who are eligible to participate in the electronic filing of Iowa individual income tax returns. Generally, if an individual or company is eligible to participate as an “electronic filer” for purposes of filing federal income tax returns electronically, the individual or company is also eligible as an “electronic filer” for filing Iowa returns electronically. However, an individual or company who is eligible as an “electronic filer” for federal purposes may be denied participation in the Iowa electronic filing program if the individual or company is not registered to do business in the state, has outstanding tax liabilities with the state, or fails to follow guidelines for filing returns in the electronic filing program for Iowa returns. The major types of “electronic filers” are described below with any special requirements for participation as an electronic filer of Iowa returns:

a. An electronic return originator (ERO) is either (1) an electronic return preparer who prepares returns, including Form IA 8453, for individuals who intend to have their Iowa returns electronically filed; or (2) an “electronic return collector” who accepts completed tax returns, including Form IA 8453 from taxpayers who intend to have their Iowa returns electronically filed.

b. A transmitter sends completed returns directly to the Internal Revenue Service, Service Center, using software that has been approved by the IRS and the department. A transmitter may accept Iowa returns from approved electronic filers for direct transmission to the Service Center.

c. A software developer creates or produces the tax preparation and transmission software that allows the data from the return to be transmitted to the Service Center via computers. Software developers are required to submit a letter of intent which is to include the name, address, and telephone number of a contact person and a copy of IRS Form 8633 (Application to Participate in the Electronic Filing Program) in order to be considered for participation in the Iowa electronic filing program for that year for returns filed starting in January of the next year.

Specifications for the software developers are explained in IRS Publication 1346 and Iowa Publication 16-107, “Electronic Return File Specifications and Record Layouts.” The developers also will be provided with test data and instructions so they can test their programs for processing electronic returns with the Iowa department of revenue and finance.

The software developers will be required to pass transmission tests before their software programs will be approved for electronic filing of Iowa income tax returns.

Note that the various categories of “electronic filers” are not mutually exclusive. There may be cases where a particular “electronic filer” performs all functions involved in the electronic filing of Iowa returns.

39.13(2) *Form IA 8453 (Iowa Individual Income Tax Declaration For Electronic Filing).* For the 1994 and 1995 tax years, Form IA 8453 (Iowa Individual Income Tax Declaration For Electronic Filing) must have been mailed, faxed or delivered to the department for each individual income tax return that was electronically filed with the department within one workday of the day acknowledgment of acceptance of the federal/state return was received from the Service Center. See the introductory portion of rule 39.13(422) for information on retention of the IA 8453 for the 1996 Iowa return and for returns for subsequent years. The mailing address and the fax number are listed at the end of this sub-rule. All information on the IA 8453 must match the same information on the electronic record for the return. The Declaration Control Number (DCN), the 14-digit number assigned to the taxpayer by the ERO (Electronic Return Originator) must be the same number as was used on the taxpayer’s federal return. The mailing label from the Iowa department of revenue and finance with the taxpayer’s name, address, and social security number should be affixed to the IA 8453 if the label is available. The label information should be verified and corrected. If the label is not available, the identifying information (name, address, and social security number) should be printed or typed on the IA 8453.

a. *Part I—tax return information.* The tax return information for net income, total Iowa tax, Iowa income tax withheld, and amount to be refunded (if any) should be entered in whole dollar amounts. Refund amounts may differ slightly due to the effects of rounding.

b. *Part II—direct deposit of refund.* The information in part II should be completed only in cases where taxpayers want their Iowa income tax refunds deposited into their savings or checking accounts at financial institutions. To be eligible for direct deposit, taxpayers must provide proof of account ownership, such as a check, form, report, or other statement generated by the financial institution that has the taxpayer's name, the nine-digit Routing Transit Number (RTN), and the depositor account number preprinted on the statement or form. The account designated to receive the direct deposit must be in the taxpayer's name. If the taxpayer's filing status on the return is married filing jointly or separately on the combined return form, the account can be in either or both spouses' names. If the filing status is married filing separately, the account can be in the taxpayer's name or a joint account in both spouses' names. If the filing status is married filing separate returns, a direct deposit cannot be made if the account is only in the name of the other spouse.

c. *Part III—taxpayer's declaration.* The taxpayer must sign the taxpayer declaration. Both spouses must sign the declaration if a joint return or a separate on the combined return is being filed. The signature allows the department to disclose to the ERO or transmitter any reasons for delay in processing the return or refund.

The signature of one spouse also provides irrevocable approval of a direct deposit to the checking or savings account of the other spouse when a joint return or combined return is filed by the taxpayers.

If the ERO makes any changes to the electronic return after the taxpayer(s) has signed the IA Form 8453, but before the electronic return is transmitted, and the net income on the IA 8453 is different from the amount on the return by more than \$25 or the total Iowa tax on line 2, tax withheld amount on line 3, refund amount on line 4, or tax due amount on line 5 of Form IA 8453 differs from the amount on the corresponding line on the electronic return by more than \$7, a new form must be completed and signed by the taxpayer(s).

d. *Part IV—declaration of electronic return originator (ERO) and paid preparer.* The ERO must sign Form IA 8453. If the ERO is not the paid preparer for the tax return, the paid preparer must also sign the IA 8453 in the space for paid preparer near the bottom of the form.

e. *Attachments to Form IA 8453.* The following are the documents that should be attached to Form IA 8453:

(1) Forms W-2, W-2G and 1099R to support amounts of Iowa income tax withheld that were claimed on the electronic portion of the return.

The refund of the taxpayer's overpayment cannot be allowed until the information from the W-2s and 1099Rs supporting the Iowa income tax withheld is provided to the department.

(2) Copies of returns of states other than Iowa for returns where out-of-state tax credits were claimed on line 66 of the IA 1040. The out-of-state tax credits claimed on electronically filed returns cannot be allowed in processing of the returns until the information from the IA 130 form(s) supporting the credits is provided to the department. Forms IA 8453 can be mailed to: Electronic Filing, Iowa Department of Revenue and Finance, P.O. Box 10469, Des Moines, Iowa 50306-0469. The forms can be faxed to the department at (515)281-6408.

39.13(3) *Direct deposit of taxpayers' refunds from electronically filed Iowa returns.* A feature of the Iowa electronic filing program is that taxpayers can designate direct deposit of state income tax refunds on their returns. The department does not guarantee a specific date by which a refund will be directly deposited in the taxpayer's account at a financial institution. Because of confidentiality statutes, the department cannot provide information to an electronic filer about possible delay or possible denial of a direct deposit without proper written authorization of the taxpayer. The department is not responsible for the misapplication of a direct deposit of a taxpayer's income tax refund that is caused by error, negligence, or malfeasance on the part of the taxpayer, electronic filer, financial institution, or any of the agents of any of the above-named individuals or entities.

The following are some of the responsibilities of an electronic filer to the taxpayer in an instance where the taxpayer has requested direct deposit of an income tax refund:

- a. Ensure that the taxpayer is aware of all general information about a direct deposit.
- b. Accept any direct deposit election to any eligible financial institution designated by the taxpayer.
- c. Ensure that the taxpayer is eligible for direct deposit.
- d. Verify that the direct deposit information provided by the taxpayer for Form IA 8453 is correctly entered on the form and transmitted with the electronic portion of the form.
- e. Advise the taxpayer that once an electronic return has been accepted for processing by the department the direct deposit election cannot be rescinded, the Routing Transit Number (RTN) of the financial institution cannot be changed, and the taxpayer's account number cannot be changed.
- f. Advise the taxpayer of the procedures to be followed if there is a need to contact the department about a direct deposit request.
- g. Not mislead a taxpayer about why a direct deposit election was denied.

39.13(4) *Information electronic filer must provide to the taxpayer.* The electronic filer must provide the taxpayer whose return was electronically filed the following information:

- a. A paper copy of the electronic data that was transmitted to the department from the taxpayer's Iowa return. This information can be supplied on replicas of the federal and state forms that make up the individual's return or can be included on unofficial forms. If unofficial forms are used, data entries must include references to line numbers on the forms.
- b. A copy of Form IA 8453 and copies of the W-2s, 1099Rs and other attachments that were submitted with Form IA 8453.
- c. The taxpayer is to retain a complete copy of the return, including supporting forms and schedules.
- d. If an amended return needs to be filed, it must be filed on a paper return form and cannot be filed electronically.
- e. If a taxpayer inquires about the status of a refund, the ERO must advise the taxpayer to use the department's automated 24-hour line.
- f. The taxpayer's address on the electronically filed return will be considered to be the taxpayer's "last known address" for all purposes of the department. That is, this address will be used to contact the taxpayer about possible problems on the taxpayer's return or for issuance of a notice of deficiency for unpaid tax.

39.13(5) *Electronic filing of Iowa returns and tax items that disqualify electronic filing of Iowa returns.* Individuals who want to file their Iowa income tax returns electronically must have these returns filed at the same time their federal returns are filed electronically. Pursuant to an agreement between the department and the Internal Revenue Service, data from a taxpayer's Iowa return is to be transmitted to the Internal Revenue Service Center in Austin, Texas, at the same time data from the taxpayer's federal return is transmitted to the Service Center. The data for the state return is stored in the Service Center until department personnel retrieve the data for processing of that return. Prior to the period for the filing of income tax returns starting in January following the tax year, the department will publicize the dates when Iowa individual income tax returns can be filed electronically. These dates will coincide with the dates when taxpayers may file their federal income tax returns electronically. For example, 1995 Iowa and federal returns will be filed electronically from January 12, 1996, through October 15, 1996.

a. The following are the major requirements that must be met in order for an individual to file the Iowa income tax return electronically unless the taxpayer also has one or more disqualifying items listed under paragraph "c" in this subrule:

(1) Returns must be for the calendar year. Thus, fiscal-year filers and individuals that have a short tax year cannot file electronically. Individuals who were part-year residents of Iowa in the tax year can file electronically if they are calendar-year filers.

(2) Returns must be original returns. Thus, if an original Iowa return has been filed, an amendment of that return must be filed on a paper return form.

(3) Returns for the 1994 and 1995 tax years must have been filed for refund or for no tax due. However, for tax years beginning with the 1996 calendar year, tax due returns may be filed electronically as well as returns for refund or no tax due. It is the responsibility of the ERO to provide payment voucher forms and the address where payments are to be sent to taxpayers with electronically filed tax due returns. Taxpayers that have tax due electronically filed Iowa returns are subject to the same penalties and interest on the tax due amounts as taxpayers that have filed tax due paper returns. However, in cases where taxpayers' tax due returns are filed electronically prior to the due dates of the returns, the taxpayers can avoid possible penalties and interest by paying the tax due amounts on or before the due dates of the returns.

(4) Returns must be filed using the format of the IA 1040. Taxpayers who are eligible to file on the IA 1040A (short form return) can file electronically but must use the IA 1040 Form arrangement.

b. The following are the major Iowa income tax forms, schedules and worksheets that can be used on Iowa returns filed electronically:

(1) IA-Schedule A—itemized deductions.

(2) IA-Schedule B—interest and dividends.

(3) IA 41-104—itemized deduction worksheet.

(4) IA 100—Iowa capital gains schedule.

(5) IA 126—Iowa nonresident and part-year resident credit schedule.

(6) IA 130—out-of-state tax credit computation schedule (two of these forms can be included in the electronic return).

(7) IA 4136—motor vehicle fuel tax credit.

(8) IA 2210 and IA 2210F—underpayment of estimated tax by individuals and underpayment of estimated tax by farmers and fishers.

The following are some of the major federal schedules and forms that can be included as part of the Iowa electronic return for the tax year as well as the federal return form (1040, 1040A, or 1040EZ):

1. Schedule C—business income or loss
2. Schedule D—capital gains or losses
3. Form 4797—sales of business property
4. Schedule E—supplemental income and loss
5. Schedule F—profit or loss from farming
6. Form 3903—moving expenses
7. Form 2106—employee business expenses
8. Form 2441—child and dependent care credit
9. Form 2119—sale of your home
10. Form 4684—casualties and thefts
11. Form 4835—farm rental income and expenses

c. Taxpayers are disqualified from filing electronically for the tax year if the return includes any of the following conditions, taxes, credits or deductions:

- (1) Taxpayer was deceased sometime in the tax year or individual who was deceased in the tax year is included on joint or combined return with the surviving spouse.
- (2) Returns with lump sum tax (line 47, IA 1040).
- (3) Returns with minimum tax (line 48 and Form IA 6251).
- (4) Returns with disability income exclusion (line 21, IA 1040 and Form IA 2440).
- (5) New jobs credit (line 57 and Form IA 133).
- (6) Minimum tax carryforward credit (line 57 and Form IA 8801).
- (7) Seed capital credit (line 57, IA 1040).
- (8) Research activities credit (line 68 and Form IA 128).

Note that the line references to the taxes, exclusion, credits, and penalty given above are to lines on the IA 1040 for 1994. Different line numbers may apply to these tax items on the IA 1040 for tax years after 1994.

39.13(6) *Monitoring of electronic filers.* The department will monitor the filing of Iowa returns by electronic filers to ensure compliance with all rules for electronic filing under rule 39.13(422). Some of the specific aspects of monitoring of the filing of Iowa returns by electronic filers follow:

a. The department will monitor the timely receipt of Form IA 8453 for all electronic returns filed with the department as well as the legibility of these forms. The department will also monitor the timely receipt of W-2s and other states' returns with the IA 8453 forms and the legibility of these forms. However, in the case of Forms IA 8453 for 1996 returns and for returns for subsequent years where the forms are not mailed, faxed, or delivered to the department, the department will randomly request the forms and attachments to ensure that EROs are properly retaining the forms and those tax documents that are to be attached to the IA 8453 such as W-2s, 1099s, and out-of-state returns.

b. The department will monitor the quality of an electronic filer's transmission of taxpayers' Iowa income tax returns throughout the period for filing returns. The department will also monitor the electronic returns filed and tabulate rejections of returns, errors on returns and other defects that apply to each electronic filer.

c. The department will monitor complaints about an electronic filer to the extent the complaints pertain to the electronic filing of Iowa income tax returns.

d. In its monitoring of electronic filers, the department will advise the filers about the deficiencies described in paragraphs “a,” “b,” and “c” of this subrule. The department will advise the electronic filers of possible actions to correct the deficiencies and provide other types of assistance to ensure the filing of accurate and complete Iowa returns.

See subrule 39.13(7) about suspension of electronic filers from the Iowa electronic filing program.

39.13(7) *Suspension of an electronic filer from participation in the Iowa electronic filing program.* The department can immediately suspend, without notice, an electronic filer from the Iowa electronic filing program. However, in most cases, a suspension in the Iowa electronic filing program is effective as of the date of the letter informing the electronic filer of the suspension. Before suspending an electronic filer, the department may issue a warning letter which describes specific corrective action because of deviations from this rule.

Because a taxpayer’s Iowa return is filed at the same time as the taxpayer’s federal return and both returns are filed via the same electronic filer, if an electronic filer is either denied participation in the federal electronic filing program or is suspended from the federal program, the electronic filer is automatically prohibited from participation in the Iowa electronic filing program. An electronic filer who was either denied participation or was suspended from participation in the federal electronic filing program but later is allowed participation in the federal program is also eligible for participation in the Iowa electronic filing program.

An electronic filer who is eligible to participate in the federal electronic filing program may be suspended from the Iowa electronic filing program if the electronic filer has any of the following. This list is not all-inclusive.

- a.* Deterioration in the format of transmissions of individual Iowa returns;
- b.* Unacceptable cumulative error or rejection rate or failing to correct errors in transmission of Iowa returns;
- c.* Untimely received, illegible, incomplete, missing, or unapproved substitute Forms IA 8453;
- d.* Stockpiling returns at any time while participating in the Iowa electronic filing program;

NOTE: “Stockpiling” means collecting returns from taxpayers or from another electronic filer prior to official acceptance into the Iowa electronic filing program, or after official acceptance into the program, waiting more than three calendar days to transmit a return to the department after receiving the information necessary for an electronic transmission of a return.

- e.* Failure on the part of the transmitter to retrieve an acknowledgment file within two working days of transmission by the department;
- f.* Failure on the part of the transmitter to initiate the communication of acknowledgment files to electronic return originator (ERO) within two working days of transmission by the department;
- g.* Significant complaints about the electronic filer;
- h.* Failure on the part of the electronic filer to cooperate with the department’s efforts to monitor electronic filers, investigate electronic filing abuse, and investigate the possible filing of fraudulent returns;
- i.* Submitting the electronic portion of a return with information which is not identical to information on Form IA 8453;
- j.* Transmitting the Iowa return with software that was not approved for use in the Iowa electronic return filing program;

k. Failure on the part of the electronic filer to provide W-2s, 1099s, or out-of-state tax returns when requested.

See subrule 39.13(8) for information on administrative procedures relating to suspension of electronic filers from participation in the Iowa electronic filing program.

39.13(8) *Administrative procedure for denial of an electronic filer's participation in the Iowa electronic filing program or for suspension of an electronic filer from the Iowa electronic filing program.* In a situation where an electronic filer has requested participation in the Iowa electronic filing program, but there is a reason to deny the electronic filer's participation, the department will send the electronic filer a letter to advise that the electronic filer will be denied entry into the program. In another situation where an electronic filer is a participant in the Iowa electronic filing program but the electronic filer is to be suspended from the program for a problem or problems described in subrule 39.13(7), the department will send the electronic filer a letter to notify the filer about the electronic filer's suspension from the program.

In cases where the electronic filer either disagrees with the denial of participation letter or the suspension from participation letter, the electronic filer must file a written protest to the department within 60 days of the date of the denial letter or the suspension letter. The written protest must be filed pursuant to rule 701—7.8(17A). During the administrative review process, the electronic filer's denial of participation or suspension from participation in the Iowa electronic filing program will remain in effect.

This rule is intended to implement Iowa Code sections 422.21 and 422.68 as amended by 1996 Iowa Acts, chapter 1167.

701—39.14(422) Tax benefits for persons serving in support of the Bosnia-Herzegovina hazardous duty area. For tax years beginning on or after January 1, 1995, a number of state tax benefits are authorized for individuals serving in a location designated by the President and Congress as a qualified hazardous duty area or other persons serving in support of the individuals in the hazardous duty area. Public Law No. 104-117 was enacted by Congress on March 20, 1996, and designated Bosnia, Herzegovina, Croatia, and Macedonia as a qualified hazardous duty area so that troops performing peacekeeping duties in the area would be eligible for tax benefits for federal income tax purposes on the same basis they would have been eligible for the same benefits if they had served in a combat zone under prior law.

For Iowa tax purposes, persons serving peacekeeping duties in the hazardous duty area or other persons serving overseas in support of the persons in the hazardous duty area will be eligible for the same tax benefits that were previously only available to persons serving military duties in a combat zone. The tax benefits that are available for persons serving in the hazardous duty area or persons serving overseas in support of the persons in the hazardous duty area are described in rule 39.12(422).

This rule is intended to implement Iowa Code section 422.3 as amended by 1996 Iowa Acts, Senate File 2168.

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